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NEWS RELEASE

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PSC OKs Kentucky-American Water Pipeline to Owenton *Cost recovery to be determined in rate case*

FRANKFORT, Ky. (Feb. 28, 2013) – The Kentucky Public Service Commission (PSC) has authorized Kentucky- American Water Co. to build a pipeline that will connect its customers in the Owenton area to the company's water treatment plant on the Kentucky River in Owen County.

In an order issued today, the PSC found that building the pipeline and related storage tanks is more cost-effective than making improvements to Owenton's aging treatment facility, which Kentucky-American owns and operates.

However, the PSC did not determine how Kentucky-American will recover the cost of the new facilities and how those costs will be allocated. Those issues will be resolved separately in a pending Kentucky-American rate proceeding, the PSC said.

Kentucky-American has about 3,900 customers in its Northern Division in Owen, Gallatin and Grant counties. They use about a million gallons of water per day.

The division was created through the acquisition of several small water systems, including the city of Owenton system. Nearly 90 percent of the Northern Division customers receive water from the Owenton plant, with the rest receiving water that Kentucky-American purchases from neighboring water systems.

A "substantial inadequacy of service currently exists or will shortly exist in the Northern Division" and the division "presently lacks an adequate and reliable source of supply to meet the needs of its customers," the PSC said in its order.

The Owenton plant is "substantially deficient" and "poses an unacceptable risk to the continuity of service," in addition to being unlikely to meet stricter federal water quality standards, the PSC said.

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The vast majority of Kentucky-American's customers – about 119,000 - are located in the company's Central Division, which serves Fayette and six surrounding counties. The company also provides water to nine other water districts or municipal systems.

The water treatment plant on the Kentucky River – known as Kentucky River Station II - was approved by the PSC in April 2008 and went into service in 2010. It has a capacity of 20 million gallons per day and is connected to Kentucky-American's Central Division by a 31-mile pipeline. It is one of three plants serving the Central Division.

Kentucky-American applied for a certificate for the Owenton construction project on March 31, 2012. The PSC held an evidentiary hearing on the matter on Oct. 16, 2012. The Kentucky Office of Attorney General and Lexington-Fayette Urban County Government were parties to the case.

In its application to connect customers of the Owenton system to the Kentucky River Station II plant, Kentucky-American proposed to construct about 16 miles of pipeline and a pump station. The project also includes a 300,000-gallon storage tank outside Monterey and a 600,000-gallon tank near Owenton.

The total cost of the project is estimated to be \$14.1 million.

Kentucky-American cited a number of problems with the Owenton plant and system, including physical deterioration, inadequate treatment and storage capacity, poor reliability, a lack of backup systems, and problems with water supply and quality in the warmer months.

Correcting all of those problems would cost about \$11.4 million, the company said in its application.

Although that is \$2.7 million less than the cost of the pipeline and new tanks, the higher cost is quickly offset by the elimination of the operation and maintenance expense of the Owenton plant. Kentucky-American also would reduce its need to purchase water from other water systems in order to serve those customers not served from Owenton.

The immediate annual savings would be more than \$600,000, meaning that the cost difference would be erased in the first three years of operation, the PSC found.

Both the Attorney General and Lexington-Fayette Urban County Government questioned whether Central Division customers should bear a portion of the cost of the project. The PSC said that question would be addressed in the pending rate case.

The Attorney General also raised the issue of whether Kentucky-American acted reasonably in purchasing the Owenton system, knowing that a substantial investment would be needed to bring it into a safe and reliable operating condition. The commission noted that a utility under its jurisdiction is not required to obtain PSC approval to before purchasing a municipal water system.

However, the PSC may review the reasonableness of all costs associated with such a purchase and decide whether they can be recovered through rates. In today's order, the PSC said the issue of costs stemming from Kentucky-American's purchase of the Owenton system will be considered in the pending rate case.

The PSC said that it has encouraged regionalization of water supply, including acquisitions by larger utilities such as Kentucky-American of small and less efficient water systems. However, the PSC has not defined parameters for cost allocation in such instances. The pending rate case is the proper forum for that discussion, the PSC stated in the order.

Today's order, case records and a video of the hearing are available on the PSC website, psc.ky.gov. The case number is 2012-00096.

The case number in the pending rate proceeding is 2012-00520. A public comment meeting and evidentiary hearing in that case will be conducted later this year.

The PSC is an independent agency attached for administrative purposes to the Energy and Environment Cabinet. It regulates more than 1,500 gas, water, sewer, electric and telecommunication utilities operating in Kentucky and has approximately 90 employees.